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NO. 83-1585

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

IN THE MATTER OF:

VILLAGE PROPERTIES, LTD.,
A California Partnership,
d/b/a Wolters Village Apartments,

Bankrupt.

WOLTERS VILLAGE, LTD.,

Petitioner,

VS.

VILLAGE PROPERTIES, LTD.,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF RESPONDENT IN OPPOSITION

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QUESTION PRESENTED FOR REVIEW

Did the Court of Appeals for the Fifth Circuit err in holding that the decision in *Butner v. United States,* 440 U.S. 48 (1979), which held that state law controls the validity and scope of security interests in bankruptcy proceedings, is still valid under the new Bankruptcy Code?

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TO THE HONORABLE SUPREME COURT OF THE UNITED STATES:

The Respondent respectfully submits this Brief in Opposition to the Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit.

STATEMENT OF THE CASE

The Petitioner's Statement of the Case contains material omissions and inaccuracies which the Respondent wishes to correct with the following Statement of the Case.

This case arises out of a Chapter 11 bankruptcy filed by the Respondent on May 5, 1980. On June 5, 1980, the Petitioner filed in Bankruptcy Court a Complaint to Modify Stay (R. 142), seeking to foreclose a deed of trust ("Deed of Trust") covering the sole substantial asset of the Respondent, an apartment project known as Wolters Village Apartments (the "Apartment Project"). The Deed of Trust secured payment of a promissory note executed by Southland Capital Properties, Ltd. ("Southland Capital"), payable to the Petitioner.

Petitioner's Complaint to Modify Stay was adjudicated in Bankruptcy Court on July 17, 1980. Pursuant to Order of the Bankruptcy Court allowing such (R. 51-52), on September 2, 1980, the Deed of Trust securing the payment of Southland Capital's promissory note was foreclosed, and Petitioner thereby acquired possession of the Apartment Project.

Significantly, the Complaint to Modify Stay was the only pleading filed by Petitioner in this cause between the filing of the Chapter 11 Petition on May 5, 1980 and the foreclosure sale on September 2, 1980. Prior to the foreclosure sale, Petitioner did not petition the Bankruptcy Court for the appointment of a receiver to collect rents for the benefit of Petitioner (R. 77), nor did Petitioner petition the Bankruptcy Court for an order of sequestration (R. 77), or any other order for the purpose of impounding rents collected by the Respondent (R. 77). Petitioner never alleged a lack of adequate protection with regard to rents.

In spite of these facts, Petitioner filed a Proof of Claim after foreclosure (R. 53-75), asserting a right to rents collected during the period between Southland Capital's alleged default under the terms of the promissory note and the foreclosure sale.

In a trial on stipulated facts, the Bankruptcy Court on February 11, 1981 denied the Proof of Claim and ruled that Petitioner was not a creditor of Respondent's estate (R. 75). Petitioner appealed to the United States District Court for the Northern District of Texas, and on December 6, 1982, the District Court affirmed the Bankruptcy Court. Thereafter, Petitioner appealed to the United States Court of Appeals for the Fifth Circuit, and on January 27, 1984, the Court of Appeals affirmed the District Court.

SUMMARY OF ARGUMENT

Under *Butner v. United States*, 440 U.S. 48 (1979), state law determines the scope of security interests in bankruptcy proceedings. Specifically, state law determines who is entitled to rents collected on mortgaged property between the date of the Mortgagor's bankruptcy petition and the foreclosure sale of the mortgaged property.

The decision in *Butner* has not been changed by the new Bankruptcy Code. *Butner* has been considered in numerous cases under the new Bankruptcy Code, including some dealing specifically with assignment of rents, and each has confirmed that *Butner* is still applicable. Additionally, section 552 of the new Bankruptcy Code codifies the deference of Congress to state law in the area of the effect of security interests. Section 363 of the Code does not change the result, because the Bankruptcy Court must still refer to state law in applying that provision.

Accordingly, Petitioner's Writ of Certiorari should be denied.

ARGUMENT

THE COURT OF APPEALS PROPERLY UPHELD THE JUDGMENT OF THE DISTRICT COURT AND THE ORDER OF THE BANKRUPTCY COURT IN DISMISSING PETITIONER'S CLAIM BECAUSE OF THE WELL SETTLED RULE THAT STATE LAW CONTROLS THE VALIDITY AND SCOPE OF SECURITY INTERESTS IN BANKRUPTCY PROCEEDINGS UNDER THE BANKRUPTCY CODE.

A. *Butner v. United States*, 440 U.S. 48 (1979)

In *Butner v. United States*, 440 U.S. 48 (1979), a unanimous Supreme Court held that state law would determine the scope of security interests in bankruptcy proceedings. 440 U.S. at 54-55. The Supreme Court in *Butner* explicitly rejected the notion of a federal rule of equity automatically giving a mortgagee a post-petition security interest in rents regardless of whether such an interest would be recognized under state law. Although the Supreme Court did note that Congress has the power to fashion a uniform rule governing the extent of a mortgagee's interest in rents in a bankruptcy proceeding, *id.* at 54, the Court also noted that when Congress has not exercised that power the determination of property interests in a bankruptcy proceeding *must be left to state law:*

> Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interest should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding. *Uniform treatment of property interests by both state and federal courts within a state serve to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving a "windfall merely by reason of the happenstance of bankruptcy".*

Id. at 55.

B. *The Bankruptcy Code preserves the rule of Butner*

Although *Butner v. United States* was decided under the Bankruptcy Act of 1898, the effect of *Butner* since the adoption of the Bankruptcy Code has been considered in a number of reported cases, including several dealing specifically with assignment of rents. Each decision has affirmed the applicability of *Butner* under the Bankruptcy Code. *See In Re Gaslight Village, Inc.*, 6 B.R. 871 (U.S. Bankruptcy Court, D. Conn. 1980) (cites *Butner* as controlling, holding that a mortgagee's rights under an assignment of rents agreement is not a matter of bankruptcy law but is a matter of state law) (6 B.R. at 874); *In Re Oak Glen R-Vee*, 8 B.R. 213 (U.S. Bankruptcy Court, C.D. Cal. 1981) (cites *Butner* as controlling, stating: "In the absence of federal legislation, the right of a secured creditor to rents, income, issues, and profits from real property is determined by the law of the State where the property is located.") (8 B.R. at 216, n. 3). *Accord, In Re Jenkins*, 13 B.R. 721, 723 (U.S. Bankruptcy Court, D. Colo. 1981); *In Re Hellenschmidt*, 5 B.R. 758, 760 (U.S. Bankruptcy Court, D. Colo. 1980); *In Re Wheeler*, 5 B.R. 600, 603 (U.S. Bankruptcy Court, N.D. Ga. 1980); and *In Re Jeffers*, 3 B.R. 49, 56 (U.S. Bankruptcy Court, N.D. Ind. 1980).

C. *Section 552 also is controlling*

Section 552 of the Bankruptcy Code concerns the post petition effect of security interests created by security agreements executed prior to the Debtor's filing of bankruptcy. The Court of Appeals correctly discussed the purpose of Section 552 stating:

> Section 552 is consistent with *Butner*. Its primary design is to permit creditors to take security interests in proceeds pursuant to applicable state law, such as U.C.C. Article 9 or whatever state law applies to security interests in real property. Section 552 reflects Congress' historical concern that property rights usually should be controlled by state law instead of the "mere happenstance" of bankruptcy.

In Re Village Properties, Ltd., 723 F.2d 441, 444 (5th Cir. 1984).

D. *Section 363 of the Code does not affect the rule of Butner*

The discussion of Section 363 "cash collateral" in Petitioner's Petition for Writ of Certiorari begs the question of the applicability of state law. Section 363 defines "cash collateral" as: "cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents in which the estate and an entity other than the estate *have an interest.*" Obviously, bankruptcy courts must turn to some law to use as guidance in determining whether and at what particular time an entity other than the estate has "an interest" in cash, for only at that time does it become "cash collateral." Nowhere in the Code does Congress express an intention to turn to any law other than applicable non-bankruptcy law to make such a determination, and in fact, Congress clearly mandates in Section 552(b) that state law will govern such determinations. Thus, Section 363 of the Bankruptcy Code does not preempt the rules of *Butner.*

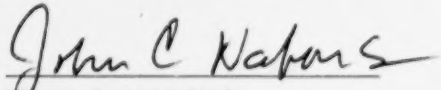
E. *Petitioner did not seek adequate protection*

Section 363 of the Code provides an explicit procedure whereby a mortgagee may obtain relief from the Section 362 automatic stay that prevents a mortgagee from foreclosing immediately on real property and obtaining a right to rents. Just as Petitioner utilized Section 363 by filing a Complaint to Modify Stay on June 5, 1980, to seek foreclosure on the Apartment Project on the grounds of lack of adequate protection, Petitioner also could have sought a sequestration of rents, appointment of a receiver to collect rents, or some other relief based on the same ground of lack of adequate protection. Yet the only pleading filed by Petitioner prior to foreclosure was the Complaint for the relief of allowing foreclosure. It was only *after foreclosure,* when Petitioner filed its Proof of Claim, that Petitioner raised the issue of cash collateral. Petitioner did not seek adequate protection with regard to rents, and therefore did not take the action contemplated by *Butner,* its progeny, and the Code.

CONCLUSION

WHEREFORE, PREMISES CONSIDERED, Respondent Village Properties, Ltd., respectfully prays that this Honorable Court deny the Writ of Certiorari to review the judgment in this case of the United States Court of Appeals for the Fifth Circuit.

Respectfully submitted,



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CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of April, 1984, three true and correct copies of the foregoing Brief of Respondent in Opposition were mailed to the Petitioner by depositing such copies in a United States mailbox, with first-class postage prepaid, addressed to Petitioner's counsel of record at his post office address as follows: Wm. Monroe Kerr, Kerr, Fitz-Gerald & Kerr, Post Office Box 511, Midland, Texas 79702.

JOHN C. NABORS